

SWBT managers have been actively promoting the goals of PURA 95 to eligible entities across the state. They have done this by producing informational brochures and videos, publishing a monthly newsletter and making personal visits with key representatives of each eligible entity. As of June 1996, SWBT managers have contacted more than 1100 schools, libraries and hospitals to discuss the goals PURA 95. This figure includes more than 500 schools districts and all 20 regional educational service centers.

Local Network Services

INTRODUCTION

The local network is comprised of a variety of services. For purposes of this analysis, SWBT has grouped these services into three major areas: *local telephone service* provided over land lines, *wireless service* to provide local calling, and "other services."

LOCAL TELEPHONE SERVICE (LANDLINE)

Local exchange carriers have traditionally supplied local telephone service, with those services carried over land-based telephone lines. Local telephone service is the most basic telephone service available. Texas customers typically pay a flat rate per month for local calling, regardless of the amount of time spent on the phone. Local calling occurs within an "exchange." An exchange is often the size of a city or community. As long as a call starts and ends within the same exchange, the call is a local call.

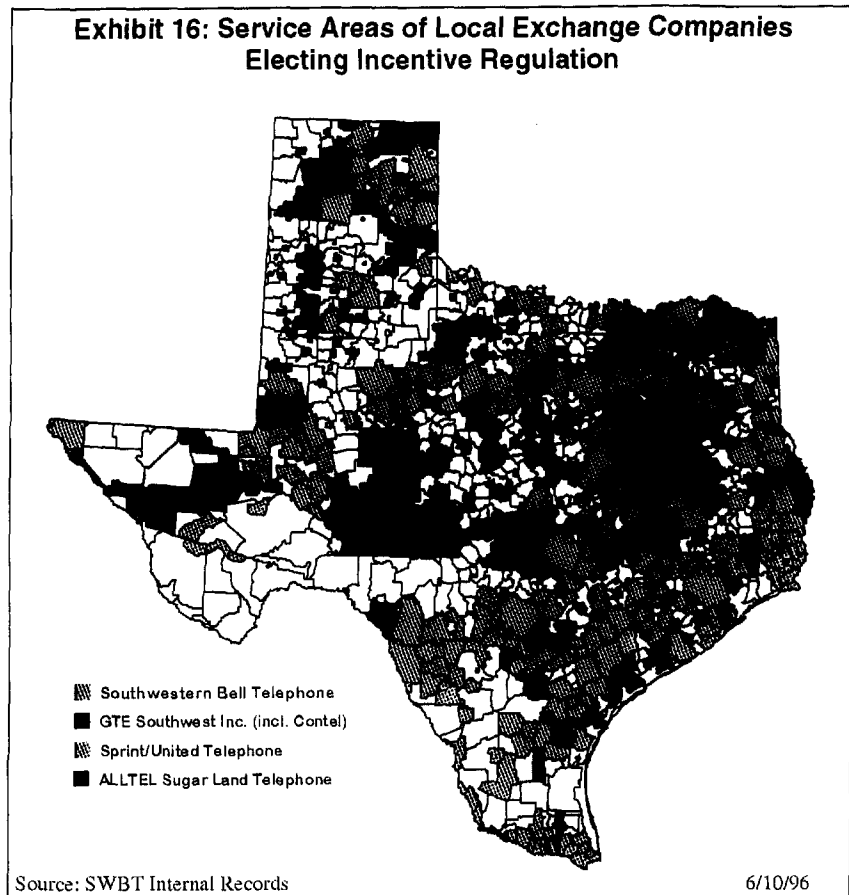
Until recently, local calling has been the province of local exchange carriers like SWBT. These carriers received a "certificate of convenience and necessity" (CCN) to operate in exclusive franchise areas without local telephone competition from other land line telephone companies. The companies' profits and services were regulated in exchange for this exclusive franchise.

Over time, circumstances changed to where this traditional model of regulation became obsolete. Cellular companies offered another alternative to local exchange company services beginning in 1984. As early as 1986, competitive access providers (CAPs) began eroding local exchange companies' state-granted franchise to deliver local access service. These companies, located in major cities in Texas, provided telecommunications services to business customers in profitable high-density metropolitan markets, bypassing the local exchange company. Price regulation and traditional local exchange franchises for local calling no longer made sense in an environment where competition existed.

Recognizing these competitive trends, House Bill 2128 (PURA 95) changed this system dramatically. Effective September 1, 1995, the new law gave local exchange companies alternatives to traditional regulation. Five local exchange companies have elected incentive regulation under PURA 95 (Exhibit 16 on the following page). PURA 95 allows multiple companies to compete for local service in previously exclusive franchise areas of local exchange companies.

PURA 95 set up two new routes for companies to compete with local exchange companies. The law gave the Texas Public Utility Commission the authority to grant companies "certificates of operating authority" (COAs) and "service provider certificates of operating authority" (SPCOAs).

The COA is reserved for facilities-based companies and is intended to promote investment and the development of advanced infrastructure in the state. To achieve this purpose, PURA 95 requires a COA grantee to serve a contiguous and compact area of at least 27 square miles, and to do so by building its own facility network. The grantee has a six-year period in which to meet build-out requirements. A COA company must use its own or leased



facilities to reach a minimum of 60 percent of its service area, but it can resell the incumbent local exchange carrier's local loops to serve the remainder.

The SPCOA ensures that not only the big players have a chance to compete for local calling. This purpose is achieved by enabling a company to resell the incumbent local exchange carrier's local loops. An SPCOA grantee buys flat-rated local exchange service at "wholesale" rates (discounted) from the incumbent local exchange carrier and resells them to its subscribers at unregulated retail rates. Anyone with less than 6 percent of the intrastate switched access MOU can apply for the SPCOA.

SPCOAs and COAs make up the new group of "local service providers" (LSPs). Like any other local exchange provider, these groups must coordinate with existing local exchange companies to "interconnect" with the existing infrastructure in their local exchanges. These interconnections are fairly complex and require detailed negotiations. *SWBT is the only one of the five local exchange companies in Texas electing incentive regulation, and the only incumbent LEC, to have negotiated such an interconnection agreement.* This agreement, signed on May 9, 1996, is with American Telco, Inc. In addition, Texas is one of only 21 states where any such interconnection agreement has been successfully negotiated to date.

The following material focuses on known and potential competition in the local exchange market. The big story in this area is the emergence of the local service providers and their ability to compete with traditional local exchange companies.

Known competition

This section on known competition deals mainly with local service providers as the significant competition of the future in the local exchange market. All local service providers that have filed with the PUC are treated as known competition for convenience of description. These providers are *known* because of their SPCOA and COA applications, but remain *potential* competition in the sense that their service areas and operations are not yet clearly defined. This section also presents information on the local switched calling offered by shared tenant service providers (STS providers).

Known local service providers

Since the enactment of PURA 95, 57 local service providers have applied to the Texas PUC for COA or SPCOA certification. As of June 10, 1996, the PUC had approved 32 local service providers; another 18 applications are pending (Exhibit 17), with one denied and six withdrawn. To date, four companies have begun offering services as SPCOAs. They are offering local services in the Dallas, Houston, Austin and San Antonio market areas.

Exhibit 17: Texas Local Service Providers					
Local Service Provider	Type of Application	Status of Application	Local Service Provider	Type of Application	Status of Application
ACSI Advanced Technologies, Inc.	SPCOA	Approved	MFS-Houston	SPCOA	Approved
AT&T	COA	Approved	MFS Intelenet of Texas, Inc.	SPCOA	Approved
AT&T	SPCOA	Pending	Nations Bell, Inc.	SPCOA	Approved
Action Telcom Co.	SPCOA	Approved	Network Operator Services, Inc.	SPCOA	Approved
Amarillo CellTelCo	SPCOA	Pending	North American InTeleCom, Inc.	SPCOA	Pending
America's Tele-Network Corp.	SPCOA	Approved	NOS Communications, Inc.	SPCOA	Approved
American Comm. Svcs.-Amarillo	SPCOA	Approved	Page One Communications	COA	Pending
American Comm. Svcs.-El Paso	SPCOA	Pending	Preferred Carrier Svcs.	SPCOA	Pending
American Comm. Svcs.-Ft. Worth	SPCOA	Pending	Progressive Concepts, Inc.	SPCOA	Approved
American Comm. Svcs.-Irving	SPCOA	Approved	Southwestern Bell Telephone	COA	Pending
American Telco	SPCOA	Approved	Sprint Communications (GTE Territory)	COA	Pending
Austin Bestline Co.	SPCOA	Pending	Sprint Communications (SWBT Territory)	COA	Pending

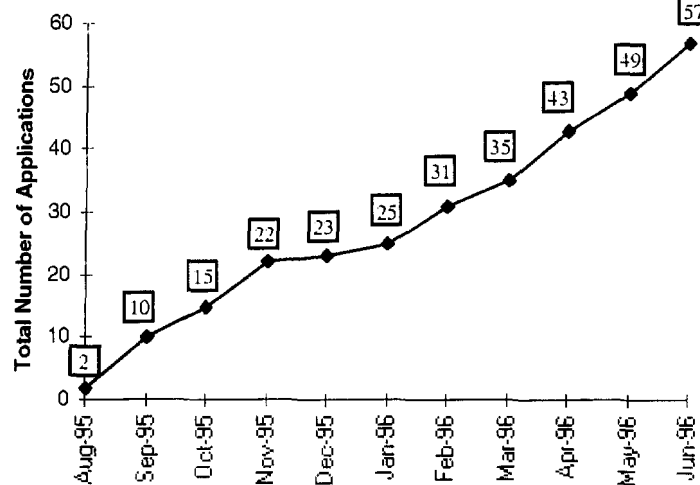
Exhibit 17: Texas Local Service Providers

Cable & Wireless, Inc.	SPCOA	Approved	Sprint Communications (SWBT Territory)	SPCOA	Pending
Capital Telecommunications, Inc.	SPCOA	Approved	Teleport - Dallas	SPCOA	Approved
Coastal Telecom Limited Co.	SPCOA	Approved	Teleport - Houston	SPCOA	Approved
CommunicationTele-Systems International	SPCOA	Pending	Texas Comm South, Inc.	SPCOA	Approved
GST Texas Lightwave, Inc.	SPCOA	Pending	Time Warner Comm. of Austin, L.P.	COA	Approved
GTE Southwest, Inc.	SPCOA	Pending	U.S. Communications, Inc.	SPCOA	Approved
Kingsgate Telephone, Inc.	COA	Approved	U.S. Long Distance, Inc.	SPCOA	Approved
LCI International Telecom Corp.	SPCOA	Approved	U.S. Telco, Inc.	SPCOA	Approved
Masters Financial Svcs.	SPCOA	Pending	USN Southwest, Inc.	SPCOA	Approved
MCI Metro Access	COA	Pending	ValuLine of Longview, Inc.	SPCOA	Approved
MCI Metro Access	SPCOA	Pending	Westel, Inc.	SPCOA	Approved
Metro-Link Telecom, Inc.	SPCOA	Approved	WinStar Wireless of Texas, Inc.	SPCOA	Approved
MFS-Dallas	SPCOA	Approved	WorldCom Inc.	SPCOA	Approved

Source: Available Public Information

6/10/96

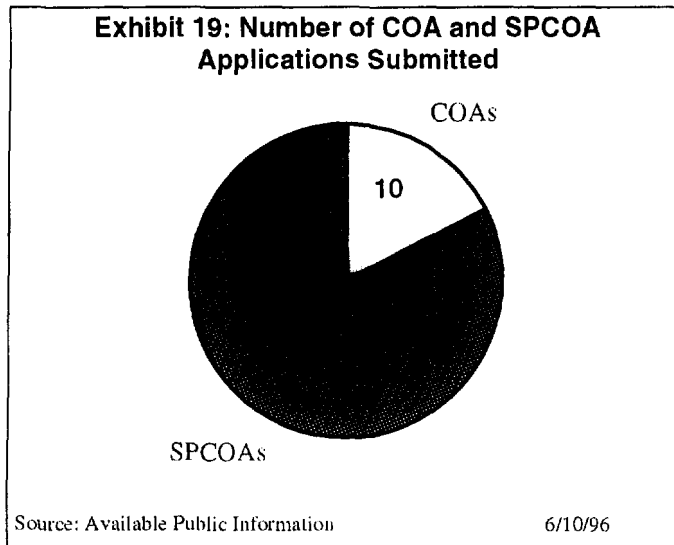
The number of LSP applications submitted to the PUC each month has remained relatively constant since enactment of the bill (Exhibit 18). This is a significant number of new local service providers. As this trend continues, an abundance of new competitors will be present in the state by the end of 1996.

Exhibit 18: Number of LSP Applications by Month

Source: Available Public Information

6/10/96

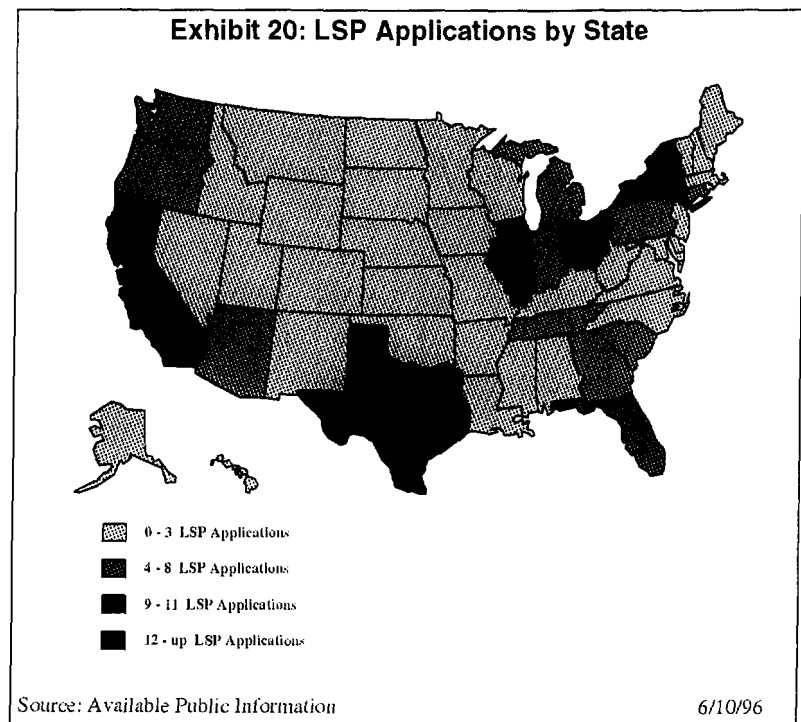
Most applicants to date have sought approval as SPCOAs (Exhibit 19). This makes sense, since most companies qualify for this type of certificate and the requirements for getting it are not as stringent as the requirements for a COA.



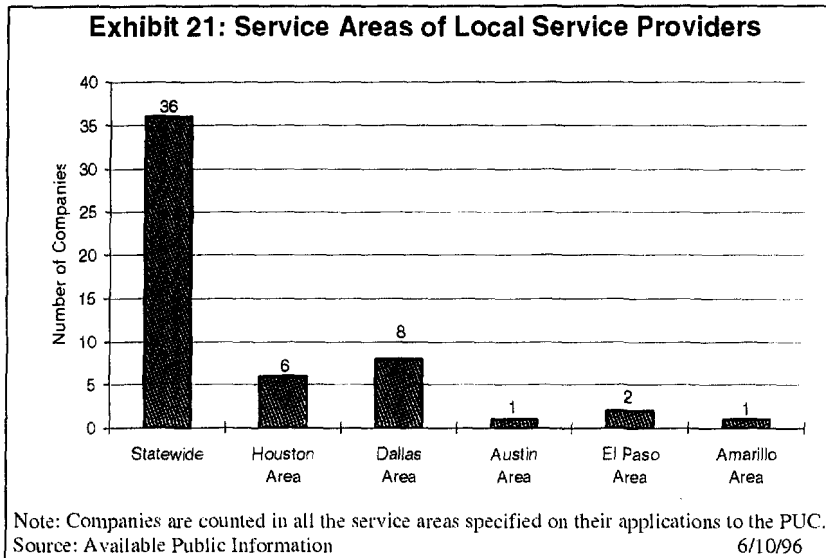
The total number of applicants for COA and SPCOA applications in Texas indicates that Texas is ahead of most states in setting up competition in local exchange calling (Exhibit 20). Only California has approved more local service applications than Texas. Of all the applications received by all 50 states, Texas has received 20.9 percent. Texas has 15.1 percent of all pending applications, and has approved 21.9 percent of all certifications granted nationwide. The bottom line is that PURA 95

has taken Texas from near zero local competition to second in the nation in ten months.

At this point, it is impossible to say with certainty whether each LSP will become a viable competitor. Indications are, however, that significant competition will emerge through the new COA and SPCOA avenues for a variety of reasons.



An examination of applications indicates that most companies are at least keeping open the option of offering service in most areas of the state (Exhibit 21). This coverage suggests ambitious competition in the future.



Another measure of potential competitive strength of Texas local service providers is their presence in other states. This presence suggests financial strength and telecommunications know-how. An examination of the eight certified local service providers in Texas indicates that all are certified, or

pending certification, to offer local service in other states (Exhibit 22). AT&T leads this group in having applications approved or pending in all 50 states.

Local service providers have subsidiaries or affiliates that offer telecommunications services of other types.

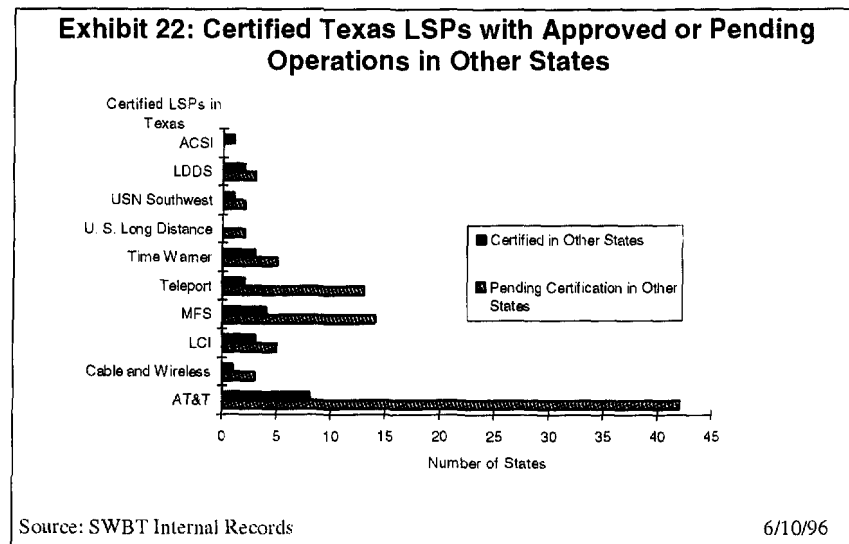
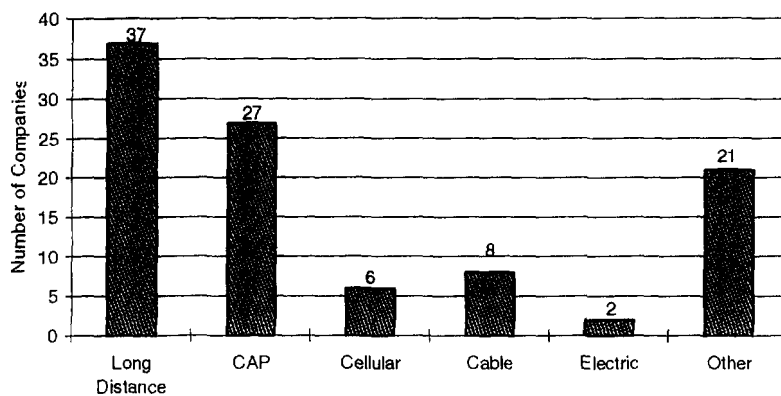


Exhibit 23: Number of Local Service Providers Offering Other Telecommunications Services

Note: Other telecommunications services provided by either company subsidiaries and/or other affiliated companies

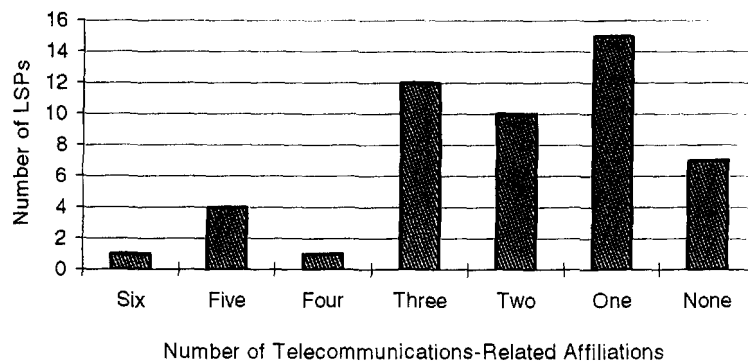
Source: Available Public Information

6/10/96

The local service providers have major relationships in six service areas: long distance, competitive access, cellular, cable and electric services, as well as other services (Exhibit 23). Long-distance and competitive access services lead the list of other telecommunications

services provided through the subsidiaries or affiliates of the local service providers. In addition, the local service providers frequently are associated with more than just one other type of service. AT&T, for example, provides services in all six areas listed above and in Exhibit 23; GTE can be found in five categories and Time Warner Communications in four. A total of 15 local service providers offer other telecommunications services in either two or three of the six service categories through their corporate relationships (Exhibit 24). These relationships offer competitive opportunities for the local service providers. They can combine local exchange calling with other telecommunications services to offer a range of services; several have the resources to do just this.

The telecommunications relationships of the local service providers also present the advantage of ready-made infrastructure for local exchange calling. It is no accident that many companies have relationships with cable, competitive access or electric service providers—companies that already have some local infrastructure in place. While electric utilities may seem a strange

Exhibit 24: Number of Telecommunications Services Offered by Local Service Providers

Note: Service areas include: long distance, competitive access, cable, cellular, electric, and "other"

Source: Available Public Information

6/10/96

affiliation at first glance, these companies often have another path to many homes and businesses. This infrastructure can be used for offering telecommunications services.

The material below highlights some of the major local service providers and the services they plan to offer.

- **AT&T**

AT&T is one of the eight COAs that has received approval to provide local exchange telephone service in Texas. However, at its request, AT&T's COA certification is limited to only those exchanges in which GTE has a certificate of convenience and necessity (CCN). AT&T has already received approval to provide local service in Texas, New York, California, Connecticut, Maryland, Michigan, Illinois and Wisconsin, and has requested certification in the remaining 42 states. Time Warner and AT&T have already agreed to connect its business customers for some local services in North Carolina.

Local calling services will only enhance the selection of AT&T's services. AT&T is the largest telecommunications company in the world and carries more than 200 million voice, data, video and facsimile messages every day. In 1995, AT&T had revenues in excess of \$79 billion dollars. In the fourth quarter of 1995, the FCC reported that AT&T's long-distance market share was 55 percent, and had increased its long-distance revenue alone by \$12 billion from the previous year. Furthermore, AT&T is expanding its services to include local telephone service, Internet access and cable television.

It is anticipated that AT&T will make a fast start into local exchange telephone service in Texas and nationally. AT&T's chairman, Robert Allen, was recently quoted as saying, "AT&T is going after local service with everything we've got." He also expressed plans for AT&T "to take at least a third" of the local telephone market within several years. The company is acting aggressively to provide such service. AT&T is reported to have targeted an advertising campaign of \$1 billion annually that would be used to advertise for services such as local telephone calling. The company is also installing more than 100 switches across the nation to route local calls within every local exchange company market nationwide. AT&T already has a customer base that reaches over 75 percent of U.S. households. This level of penetration gives the company the potential for competing head-to-head with each Bell operating company; 90 percent of AT&T's customers are also customers of the regional Bell telephone companies.

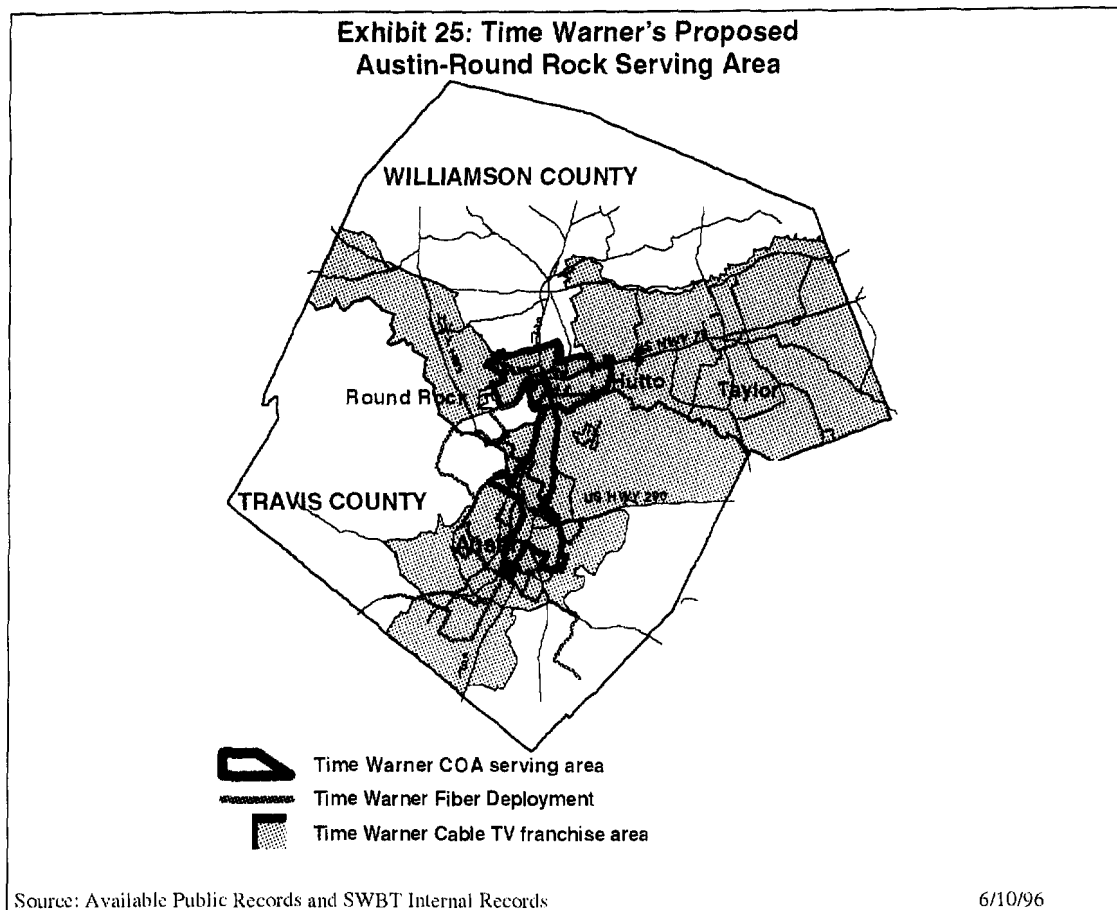
AT&T has signed agreements with five competitive access providers which will allow it to reach its business customers in 70 cities using facilities other than those provided by SWBT and other incumbent local exchange carriers. Four of the companies -- American Communications Services Inc., Brooks Fiber Properties, Hyperion Telecommunications and IntelCom Group -- have agreed to provide dedicated connections to businesses. Time Warner Communications, the fifth provider, has agreed to provide switched local exchange telephone service and switched access for businesses in addition to the dedicated access services. AT&T is negotiating with the first four companies over additional switched local services. These arrangements will allow AT&T to get access to the customer other than through the local exchange carrier for intraLATA and interLATA services as well as local service.

AT&T will be able to add local calling to an already awesome arsenal of telecommunications-related services to provide a full range of offerings. The company has invested \$23 billion in cellular wireless services. AT&T has also spent \$1.68 billion on licenses to offer "personal communications services" (PCS), a cellular-like offering that operates at a higher frequency. AT&T is spending \$4 billion more to build its PCS network and link it to its existing switches. Add to this array AT&T's Internet presence. AT&T WorldNet, its Internet service, has signed up an estimated 280,000 of its long-distance customers since February 1996 with its offer of five free hours of Internet access a month.

AT&T's aggressive plans to combine its local service with its wireless cellular service, personal communications services, as well as Internet access will eventually blur the differences between computer networks, cable television and telephone systems. SWBT believes that this company will be a major competitor in Texas and nationally as a result of these combined technologies and extensive scope of telecommunications services.

- **Time Warner**

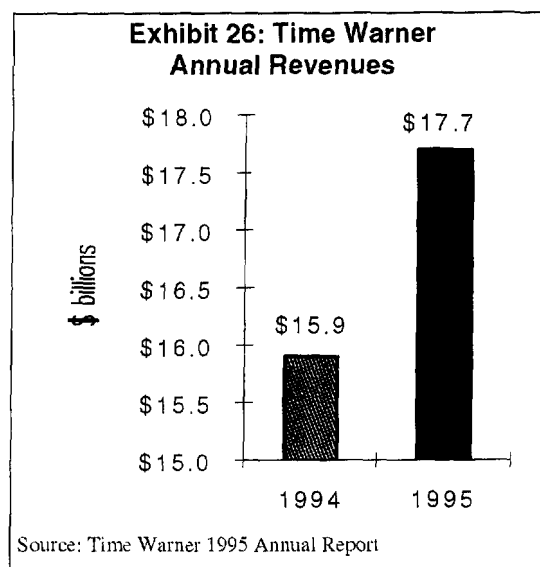
Time Warner has applied for, and been granted the authority, to operate with a COA in prime sections of the Austin-Round Rock area that it selected. Time Warner's COA application indicates that it will provide local telephone service over cable lines within a 90 square mile corridor in Austin and suburban Round Rock. Time Warner has installed a telephone switch and has upgraded its existing network to fiber optic cable. Time Warner will offer a full range of telephone services, as well as an enhanced 75-channel cable television service. Exhibit 25 on the following page illustrates Time Warner's cable television franchise, its fiber-optic networks and COA certification area to provide local telephone service in Austin.



Time Warner's financial strength and history underscore its ability to succeed as a local service provider (LSP). Time Warner is a huge conglomerate with large entertainment and telecommunications-related subsidiaries. The company's combined revenues grew by 11 percent to a total of \$17.7 billion from 1994 to 1995 (Exhibit 26).

The company's extensive resources are generated in part from a collection of telecommunications services. Time Warner made its way into the telephone business as a competitive access provider; the company now serves as a CAP in 14 major metropolitan areas, including Austin, Houston, Dallas and San Antonio. Time Warner is no stranger to local or long-distance service, either. The company was one of the first providers of alternative local exchange service to both residence and business customers in Rochester, New York. Time Warner also offers local

telephone service in Ohio, California, Florida, North Carolina and Tennessee; local service is pending in Wisconsin and Hawaii. Time Warner offers long-distance



business phone connections in 18 markets nationwide, including Orlando, Austin, and Cincinnati.

Time Warner's infrastructure gives the company excellent potential to advance its telecommunications operations in Texas and the nation. Part of its infrastructure comes from its previously mentioned competitive access operations. In addition, Time Warner cable spans the nation to deliver cable television programming to 11.7 million subscribers in 1995, making Time Warner the second largest cable television operation in the country. This cable infrastructure can be used for other telecommunications services, as well, when combined with the right technology. As an additional competitive boost, Time Warner's cable systems are among the most highly clustered cable systems in the country. The company has 35 groupings of more than 100,000 subscribers each. Having many customers close together helps keep infrastructure costs low and profits high.

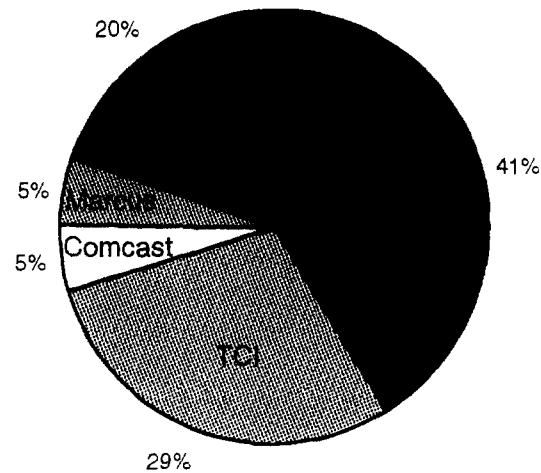
Time Warner may also gain potential competitive strength through its affiliation with US West, a Bell operating company. This company owns 25.5 percent of Time Warner Entertainment. This alliance gives Time Warner access to advanced switching technology and know-how—a crucial element for any company intending to provide local telephone service, an element that is usually missing in a pure cable TV system in addition to substantial cash revenues.

Time Warner's strong competitive potential nationally extends to local calling services in Texas. Apart from its COA to operate in the Austin-Round Rock area, Time Warner, along with several cable television companies, is finishing a project to rewire Houston to offer telephone and other services. Time Warner has both CAP and cable television operations in Houston. Time Warner's CAP and cable operations in Dallas and San Antonio could also serve as a backbone for local service in those two areas. Paragon Cable, owned by Time Warner, already provides residential telephone service to 14 San Antonio apartment complexes through the local Paragon telephone company called Time Warner Connect. Time Warner expects to offer wide-scale residential telephone service in San Antonio beginning in late 1997 or early 1998, with service extending to the entire city within two years.

Time Warner's CAP and cable infrastructure in Dallas, Houston, San Antonio and Austin offer excellent starting points for local calling in those areas. The company's local service potential does not end there, however. Time Warner is the largest cable television operator in Texas. Time Warner companies pass 41 percent, or 2.6 million, of the households in Texas (Exhibit 27).

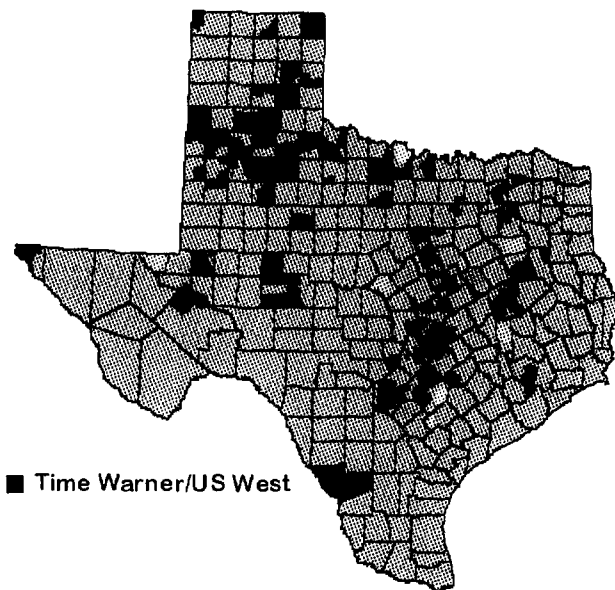
SWBT expects Time Warner to expand its local telephone service in Texas. Time Warner's clustered cable television systems and CAP networks provide Time Warner with a strong strategic position to expand its telecommunication services through its fiber-coax networks and provide new revenue streams with such services as telephony, high speed data transmission, full-motion-video access and interactive services. SWBT further anticipates that Time Warner will upgrade its networks to provide local telephone service elsewhere in the state where it has cable television systems (Exhibit 28). It appears that the Interstate 35 corridor and Texas panhandle will be Time Warner's Texas stronghold for both its cable television and telephone services.

Exhibit 27: Percent of Texas Households Passed by Cable Television Companies



Source: Television and CableFactbook, Vol. 64, 1996 Edition

Exhibit 28: Time Warner Cable Television Serving Areas in Texas



Source: Television and CableFactbook, Vol. 64, 1996 Edition, and Other Trade Publications

- **LCI**

LCI International Telecom Corporation (LCI) was approved as an SPCOA and is one of 32 telecommunications companies in Texas approved by the Public Utility Commission to provide local telephone service in competition with SWBT. According to documents filed with the PUC by LCI, the company intends to offer flat rate business and residential telephone service on a statewide basis. LCI is certified to provide local telephone service in four states other than Texas. They include California, Florida, Illinois and New York. LCI also has applications pending in three other states: Maryland, Michigan and Ohio.

LCI is a subsidiary of LCI International, Inc., the nation's sixth largest long-distance company, which currently provides facilities-based long-distance services in Texas through its subsidiary, LCI Telemanagement Corporation (LTC). News reports indicate that LCI wants to offer packages of local and long-distance services to customers in Texas, confirming speculation among industry analysts that such packages will be used by new competitors to attract consumers away from their current local telephone service provider. In fact, within the next 24 months LCI and LTC will be merged, giving the SPCOA both local and long-distance calling capabilities within Texas and the capability to reach beyond Texas through its parent company network switching facilities in such cities as New York, Atlanta, Los Angeles and Washington, D.C.

LCI is a facilities-based long-distance telecommunications provider based in Virginia that offers a broad array of domestic and international voice and data services to business and residential customers. These services include direct dial calling, toll-free 800 service, telephone debit cards and data transmission. LCI provides services to its customers through digital fiber optic facilities which are both leased and owned.

LCI is among the fastest growing long-distance companies. In 1995, LCI's revenues increased 45 percent. In addition, LCI's minutes of use increased 48 percent to 4.9 billion. The industry average for 1995 was 7 to 8 percent increase. LCI's annual revenues for 1995 were \$700 million. In the first quarter of 1996, LCI's revenues were up 46 percent over the same period last year.

In recent months, LCI has completed deals to acquire ATS Network Communications and affiliated TeleDial America. These acquisitions will expand its long-distance network into the Midwest and the South Central United States. A separate agreement to acquire Corporate Telemanagement Group, Inc. expands LCI's network into South Carolina. In addition to these acquisitions, LCI has an agreement with Bell Atlantic and NYNEX to provide long-distance services for their mobile cellular customers over a 13 state region.

Over the last three years, LCI has added network facilities in New Jersey, Atlanta, Los Angeles, North Carolina, Tennessee and Washington, D.C. through acquisitions of regional companies operating in those areas. Also, a 1994 FCC order granted LCI authority to seek agreements overseas allowing direct connections to over 40

countries. This has positioned LCI as one of a few U.S. telecommunications firms to offer facilities-based international service.

- **LDDS WorldCom**

This company was approved as an SPCOA and is one of 32 telecommunications companies in Texas approved by the Public Utility Commission to provide local telephone service in competition with SWBT and other local exchange telephone companies. According to documents filed with the PUC by WorldCom, the company intends to offer local exchange telephone services in the service areas of local exchange companies that have elected to operate under PURA 95's incentive regulation. Those companies include SWBT, GTE Southwest Inc., Central Telephone Company, United Telephone Company, and Alltel/Sugar Land Telephone Company. Taken together, the service areas of these five local exchange telephone companies cover most of the state. This, in effect, gives WorldCom statewide coverage.

WorldCom is certified to provide local telephone service in two states other than Texas: California and Connecticut. WorldCom also has an application to provide local telephone service pending in Michigan and Illinois. LDDS WorldCom is the nation's fourth largest long-distance company. WorldCom currently provides facilities based long-distance services to customers in Texas.

WorldCom indicates that the company has an interest in providing customers with the ability to obtain both local and long-distance service on a "one-stop" basis. Reselling local services is a natural extension of WorldCom's long-distance services. Since new federal legislation took effect on February 8, 1996, LDDS WorldCom has announced agreements with several local exchange companies, allowing these providers to offer their long-distance services on a resale basis.

LDDS WorldCom offers various domestic and international video, voice and data services to business and residential customers. These services include domestic local and long-distance service, 800 service, international direct dial service to over 220 countries, calling card services, enhanced fax services, data transmission services and point-to-point dedicated private line services. WorldCom provides these services to customers through a nationwide digital network that includes 11,000 miles of LDDS WorldCom digital transmission facilities and additional leased facilities, resulting in a total of 30,000 miles of network.

WorldCom is the fastest growing of the "big four" long-distance providers: AT&T, MCI, Sprint and WorldCom. In 1995, WorldCom's revenues were \$3.6 billion.

- **Teleport**

This company filed for an SPCOA and received approval on February 23, 1996 to operate as a local service provider in Texas. The company indicates that it plans to offer local calling service in Dallas and Houston.

Teleport's potential as a competitor in local service as well as other telecommunications areas goes well beyond what is visible in its application to become

an SPCOA. Its potential arises from its history as a competitive access provider and its affiliation with other service providers.

Teleport began operating as a competitive access provider (CAP) in 1989 in Dallas and Houston. It was purchased by four large cable TV companies in 1992. The purchasers, and their respective shares of ownership, are TCI (30 percent), Cox (30 percent), Comcast (20 percent), and Continental (20 percent). These companies are changing the landscape of telecommunications through mergers and joint ventures.

The cable TV companies that own Teleport, taken as a group, pass 2.3 million, or 34 percent of the homes in Texas. They are rapidly deploying fiber optic cable in preparation of providing local telephone service as well as traditional video entertainment.

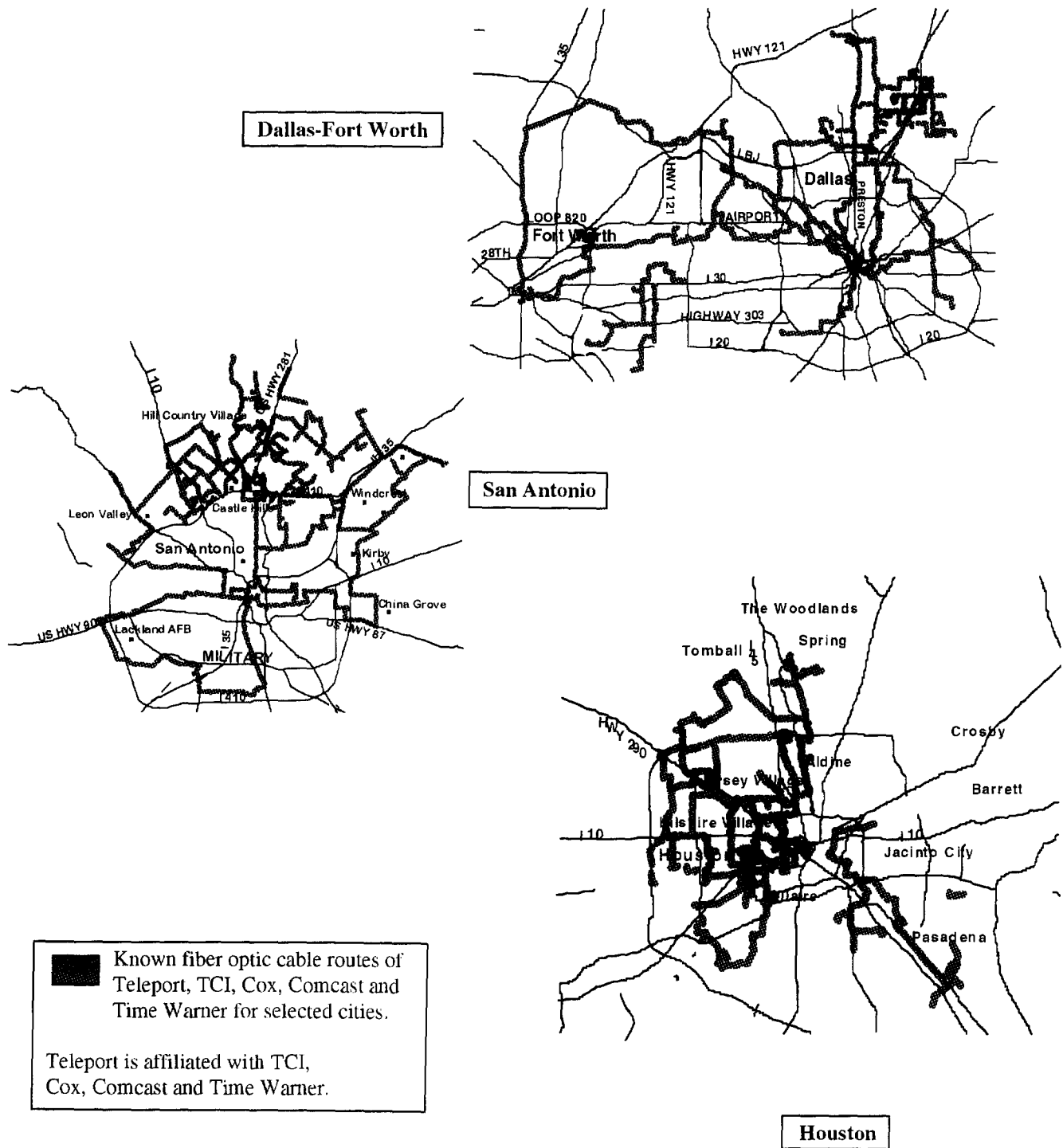
Teleport has provided competition in the local service business since its inception by directly linking large businesses with their long-distance carriers. The company grew to the point that it now serves customers in Lubbock, Dallas, Ft. Worth, and Houston. Of course, the fiber network built by Teleport is suitable for providing many telecommunications services, including local dial tone.

Along the way, Continental (and its share of Teleport) was purchased by US West, a Bell operating company. US West has pursued a strategy of acquiring cable TV companies as a way to enter the local and long-distance markets outside its traditional boundaries. In fact, US West also purchased a 25 percent stake in Time Warner, which is the largest provider of cable TV service in Texas, as well as a CAP and a local service provider (COA). Considering this link to Time Warner, the combined fiber optic networks of all the companies affiliated with Teleport in Dallas, Houston and San Antonio are shown in Exhibit 29 on the following page. Together, these networks pass 4.9 million, or 73 percent, of all homes in Texas. Teleport, with the involvement of four cable TV companies, a local exchange company with long-distance aspirations and capability, and a CAP, could provide a one-stop shop for video and telephone serving a majority of the population.

The full impact of these alliances is not complete, however, without a discussion of Sprint Spectrum. Three of the cable TV companies that own a majority of Teleport also entered a joint venture with Sprint. Again, they own a majority share, with TCI owning 30 percent, and Cox and Comcast with 15 percent each. Sprint, a long-distance provider of over ten years, owns two local exchange companies in Texas, United Telephone Co. and Centel Telephone Co. Sprint has filed three applications to provide local telephone service in Texas. The applications were filed as: COA in GTE's territory, SPCOA in SWBT's territory and COA in SWBT's territory. In fact, Sprint is the third largest local telephone company and the third largest long-distance carrier in Texas. Sprint is also the third largest long-distance provider nationally. The joint venture company, Sprint Spectrum, is planning to provide cable entertainment, local phone service, long distance, and wireless service nationwide. Each cable company plans to upgrade its network to provide local telephone service to ten million homes by 1997. In addition, these Sprint Spectrum owners spent \$2.1 billion on PCS

Exhibit 29: Teleport's Fiber Optic Networks

(Source: SWBT Internal Records)



licenses in the FCC auction. In doing so, they were the largest bidder and accessed 29 markets nationwide with 200 million potential customers. In all, \$8.4 billion in investment is planned to fully achieve the venture's goals nationwide. Sprint recently announced that the local service provided by its United and Centel companies will be re-branded under the Sprint name, creating a one-stop shop for local and long-distance telephone service. Considering the cable TV and wireless aspects of the Sprint Spectrum alliance, an all-Sprint one-stop shop is possible for both telephone and cable TV services.

Each of these two joint ventures considered separately represent huge collaborative efforts with a wide reach to compete in the local service arena. With the common ownership of TCI, Cox, and Comcast, the overall competitive strength of the two may even be greater than the sum of the two separate ventures.

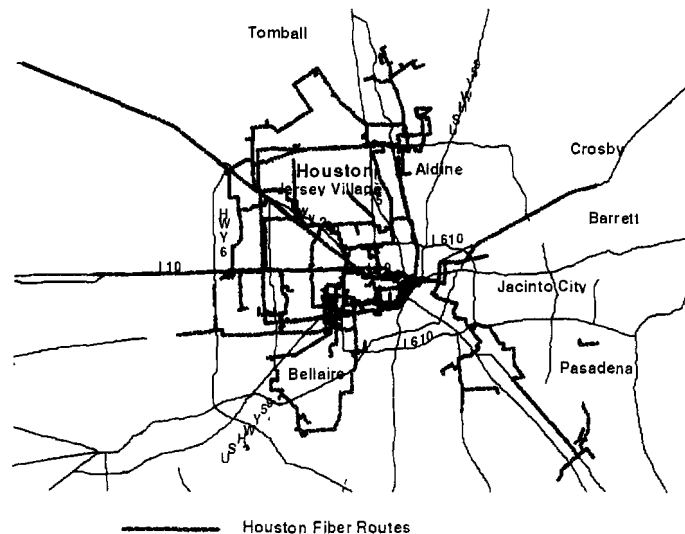
- **MFS**

Metropolitan Fiber Systems currently operates as a competitive access provider in both Dallas and Houston. The company has received approval for its SPCOA application to provide local telephone service to Texas customers. MFS's strategy is to combine its own network with the resale of local exchange company facilities.

Nationally, MFS is the largest CAP. The company's annual revenues increased by 413 percent between 1993 and 1995. Its revenue of \$583 million in 1995 represents about half of all CAP revenue in the country for that year. The competitive potential of MFS is best evaluated by examining its growth rate and its aggressive deployment of state-of-the-art technology.

In Houston, MFS uses 259 miles of fiber optic cable to reach 165 customer locations (Exhibit 30). It also has access to the fiber network of Houston Power and Light, which covers most of Houston and surrounding communities.

Exhibit 30: Houston Fiber Deployment of Selected Companies*



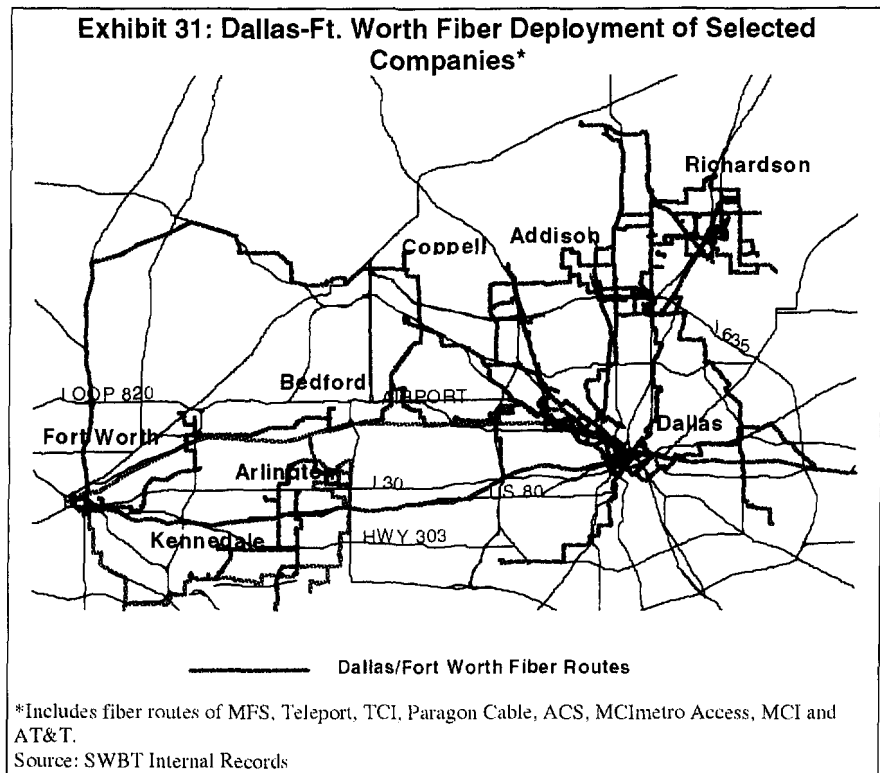
*Includes fiber routes of MFS, Teleport, TCI, Time Warner, Sprint, East Texas Company, Electra Inc., MCI and AT&T.
Source: SWBT Internal Records

In Dallas, 209 customer locations are served by 141 miles of fiber, and MFS leases excess fiber capacity from TU Electric (Exhibit 31). In addition, MFS has installed a switch at the Infomart that is capable of handling local service. MFS has given indications of planning networks in Austin and San Antonio, as well.

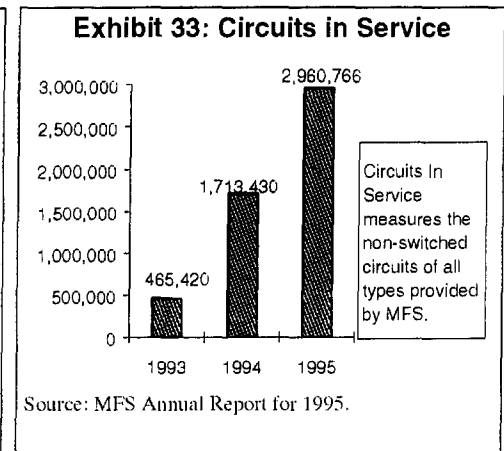
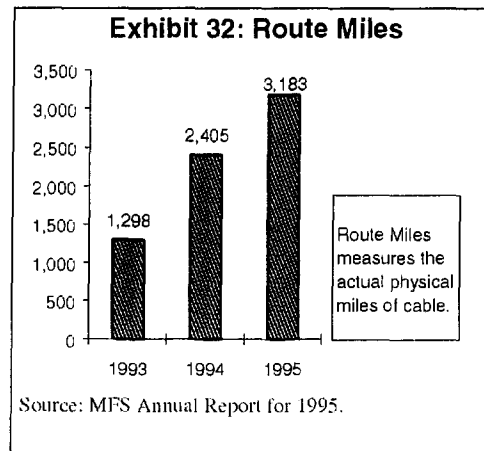
Outside of Texas, MFS is approved to provide local service in 13 other states, and has applications pending in four others. In their core businesses, MFS serves 50 major cities in the U.S. and Europe. Through MFS Telecom, it provides special access and private line service to large businesses and governmental agencies. Through MFS Intelenet, it provides a single source for both local and long-distance service, primarily to small and medium-sized businesses.

The networks MFS is building are second to none in terms of quality. They comprise a platform which can support not only access services, but enhanced voice, data and video services. The current deployment schedule calls for a total of 18 switches to be installed across the country, which will handle

MFS switching needs nationwide. This schedule also includes the infrastructure required to offer Advanced Intelligent Network (AIN) services, the new telecommunications technology supporting Caller ID, Calling Party Name, Call Blocker, Anonymous Caller Rejection, as well as other advanced communications services in the future.



The most striking characteristic of MFS is its growth. Apart from revenue growth, route miles increased by 245 percent and circuits in service



increased by 636 percent between 1993 and 1995 (Exhibits 32 and 33). This dynamic increase in all aspects of the business best indicates the future impact of MFS on the telecommunications industry.

- **GTE**

GTE is the largest local exchange telephone company in America and in 1995 had revenues of \$20 billion. Nationwide, GTE serves 12.4 million residential lines and 6.1 million business lines, with 45 percent of these access lines residing in California, Florida and Texas. GTE's wireline services cover 28 states; 15 of those states also contain GTE's wireless operations. On December 31, 1995, GTE completed its merger with Contel. The exhibits used within this section reflect this merger. Exhibit 34 indicates GTE's local and cellular telephone service in Texas as of December 31, 1995.

Exhibit 34: GTE's Texas Service Areas



Source: SWBT Internal Records

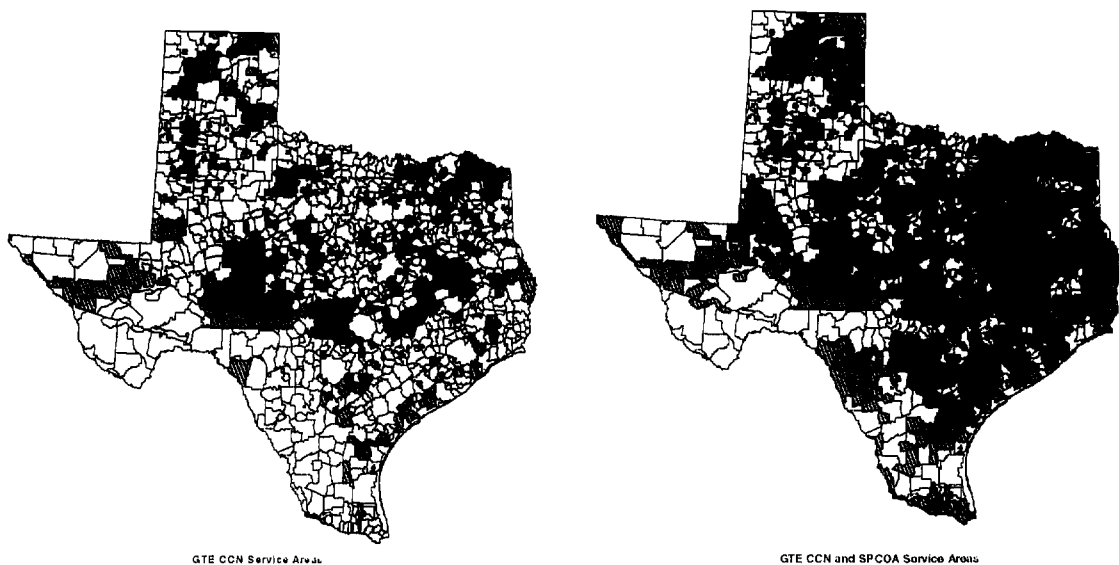
GTE is an incumbent local exchange company operating in Texas and holds a Certificate of Convenience and Necessity (CCN). GTE has also filed an SPCOA request in May. There are no contested issues related to this GTE application and it is expected to receive quick approval. GTE's CCN covers 455 exchanges and over 1.8 million access lines. The SPCOA certification allows GTE to provide local exchange telephone service in another 449 exchanges that contain approximately 8.8 million access lines. The CCN and SPCOA service areas combined cover over 97 percent of

the access lines in Texas. Exhibit 35 illustrates GTE's local exchange telephone service areas in Texas before and after the company received SPCOA certification.

GTE has also requested and been given authority to provide local telephone service in other Bell operating company exchanges in California and Florida.

GTE is the second largest wireless company in the U.S. and has 10 percent share of the national cellular market. In Texas, GTE is the third largest wireless provider and has cellular service in 11 metropolitan markets that contain approximately 6.8 million potential customers.

**Exhibit 35: GTE's Local Exchange Telephone Service Areas
Before and After SPCOA Certification**



Source: SWBT Internal Records

In 1994, GTE also introduced its Tele-Go service. This communications service is one of the first offered in Texas that combines both wireline and wireless communications through the use of one telephone instrument. Tele-Go is a cordless phone when used at home and uses the wireline network, but when the handset is out of base unit range it then becomes a mobile-cellular phone.

In March 1996, GTE entered into an agreement with the country's fourth largest long-distance company, LDDS WorldCom, to support GTE's entry into the interLATA long-distance market. GTE already offers long-distance service in six states through its agreement with WorldCom. By December 1996, GTE intends to offer this long-distance service in all 28 states where it currently offers local telephone service, including Texas.

SWBT believes that GTE will provide stiff competition not only in the SWBT franchise areas but throughout the state. GTE's competitive clout comes from its

expanded SPCOA certification, its current wireline and wireless infrastructure and in its ability to provide a range of communications service.

- **American Telco**

American Telco was approved as an SPCOA and is one of 32 telecommunications providers approved by the Public utility Commission to provide local telephone service in competition with SWBT and other local exchange telephone companies. According to documents filed with the PUC by American Telco, the company intends to provide flat rate local exchange service including extended area service, toll restriction, call control options, tone dialing, custom calling services, Caller ID and other services in the service areas of certain local exchange companies that have elected to operate under PURA 95's incentive regulation. Those companies include SWBT, GTE Southwest, Alltel/Sugar Land Telephone Company, and United Telephone Company. Taken together, the service areas of these five local exchange companies cover most of the state. This in effect gives AmericanTelco statewide coverage.

American Telco is the first of the new group of local service providers to complete an interconnection agreement with a local exchange telephone company. This agreement was signed with SWBT on May 9, 1996. Texas is one of only 21 states where any such interconnection agreement has been successfully negotiated to date.

SPCOAs and COAs must coordinate with existing local exchange companies to "interconnect" with the existing infrastructure in their local exchanges. These interconnection agreements are complex and require extensive negotiations. SWBT is the only one of the five local exchange companies electing incentive regulation in Texas to have negotiated such an interconnection agreement.

According to news reports, American Telco has already developed local and long-distance service packages. The company plans to market these packages to existing long-distance customers across Texas.

American Telco is a long-distance provider based in Houston offering services to approximately 22,000 business and residential customers across Texas. The company is switched-based, not facilities based, but leases fiber optic lines from other telecommunications providers in Texas to serve its customers. American Telco's service offerings include residential and business 800 service, specialized billing services and voice and data point-to-point private line applications as well as long-distance service.

In 1995, American Telco's revenues were \$41 million. The average annual rate of increase in revenues has been 50 percent since 1983.

Shared tenant services

Before PURA 95 certain telecommunications providers such as cable and competitive access providers had already entered the residential telephone service market through the provision of residential multi-tenant services (RMTS). RMTS is a type of local exchange telephone service offered to tenants of apartment complexes and individual buildings.

- Time Warner subsidiaries, Paragon Cable and KBL Integrated Services, have been providing local telephone service to residents of apartment complexes in San Antonio since 1994. In 1995, Time Warner acquired Paragon Cable and its CAP subsidiary Fibrcom. In August 1994, Paragon Cable announced it had formed a new subsidiary, KBL Integrated Services, to offer local telephone service to residents of area apartment complexes. News reports at that time indicated that up to 8,000 apartment customers could be getting their local telephone service from KBL Integrated Services. Time Warner Connect, a subsidiary of Paragon, is providing local telephone service at 14 San Antonio apartment complexes. Paragon officials estimate that apartment customers may number more than 3,000 by the end of 1996. Time Warner expects to offer wide scale residential telephone service in San Antonio beginning in late 1997 or early 1998, and should accomplish citywide reach within two years. Time Warner will be offering similar local telephone services elsewhere in the state where it has cable TV footholds. Those locations include Dallas, Waco, Killeen, Laredo and El Paso. Time Warner has already been approved by the PUC to offer local telephone service in Austin and surrounding areas.
- Another Time Warner subsidiary, KBL Integrated Services, is providing local telephone service to tenants of Houston area apartments. In addition, competitive access provider, Phonoscope, is targeting the Houston apartment market. It has been reported that Phonoscope, also a subsidiary of Time Warner, has installed a switch at the intersection of Loop 610 and Post Oak Drive.
- MultiTechnology Services provides local telephone services and services normally found in hotels to apartment dwellers in Dallas. These services include wake-up calls and four-digit dialing within the complex.
- U.S. Online Cable is providing local telephone service to residents of certain apartment complexes in Austin and San Antonio.

Potential competition

The previous section highlighted known competitors in the provision of local services. Companies highlighted in this section represent providers that SWBT believes are likely to become competitors for those same services in the near future. The companies listed below, such as MCI and Central and South West Corporation, are considered potential competitors because of their local service operations in other states, their presence in other telecommunications markets in Texas, and their available infrastructure.

The electric utilities listed below represent a group of potential competitors worthy of special mention. Because of changes in federal telecommunications law, their available infrastructure across Texas and a growing trend toward working with competitive access providers, electric utilities are in a unique position to compete with SWBT. Before passage of the new telecommunications law, the Public Utility Holding Company Act of 1935 (PUCHA) prohibited registered electric utility holding companies from entering telecommunications service markets. The Telecommunications Act of 1996 amended PUCHA, however, allowing such companies to provide telecommunications service

through an “exempt telecommunications company” (ETC) affiliate. The new federal law grants the FCC the authority to determine whether a holding company affiliate meets the criteria for ETC status. In essence, the affiliate’s exclusive business must be in the provision of telecommunications or information services or products. Despite the electric companies’ intent to provide local telephone service, PURA 95 clearly states that a municipality or municipal electric system may not receive a CCN, COA or SPCOA.

The following describes the activities of potential competitors. Potential competitors include long-distance companies, competitive access providers and electric utility companies.

- **Central and Southwest Corporation**

Central and South West Corporation is a Dallas based holding company, which owns three Texas electric companies. These companies are West Texas Utilities Company, Central Power and Light Company and Southwestern Electric Power Company. Central and Southwest Corporation filed with the FCC just hours after President Clinton the new bill into law. In April 1996, the FCC granted ETC status to CSW Communications, Inc., a wholly-owned subsidiary of Central and South West Corporation. According to its application, CSW Communications plans to provide utility communications services and “demand-side management services” over a fiber optic network. It also will lease excess network capacity to unaffiliated parties for the provision of communications services.

CSW Communications already manages several hundred miles of fiber optic networks owned by Central and South West and has developed its “Customer Choice and Control” program in Laredo. This program provides energy management services to utility customers through a fiber-optic based network in an effort to see how it can help its customers manage their own power usage. According to CSW officials, the program uses only 3 percent of the network leaving lots of room for telephone, cable television and high-speed connections. CSW Communications has a contract to build a similar, but wireless, network in Georgetown, just north of Austin.

In Austin, CSW Communications is negotiating with the city to operate a city-wide broadband network that will accommodate energy management services as well as competitive telecommunications, and data and video services for every home in Austin. The network would be owned and financed by CSW Communications.

- **Entergy**

The FCC granted ETC status to two subsidiaries of Entergy Corporation, a registered public utility holding company, which owns Gulf States Utilities in Texas. The two subsidiaries are Entergy Technology Co. and Entergy Technology Holding Company.

According to the FCC, the Entergy units intend to provide bulk communications capacity to other carriers, who in turn would resell such capacity to third parties. The FCC summarized the companies’ applications saying that, while the initial activities of the Entergy subsidiaries will encompass providing long-haul fiber capacity, they may also engage in providing other permitted services using both wired and wireless